



Innovations in Investing,
Saving & Advice

June 18 - 19, 2015
New York Hilton Midtown | NYC

REGISTER TODAY

AMERICAN BANKER.

If De Novos Rebound, What About ILCs?

by Ian McKendry

APR 1, 2015 2:54pm ET

WASHINGTON — With optimism growing that de novo bank activity might rebound, some observers say attention could soon shift once again to the embattled industrial loan company charter.

ILCs have been in limbo since before the financial crisis thanks to harsh scrutiny of Walmart Stores' 2005 charter application, which led to fierce debate over whether nonfinancial firms should have any access to banking. A statutory moratorium on ILCs ended nearly two years ago, but the Federal Deposit Insurance Corp. has received no applications since then.

Although Walmart withdrew its application, no federal law banning commercial or financial parents from pursuing ILCs has ever been enacted. And as the industry's continued recovery increases the likelihood of more new-bank applications overall, some observers believe interest in the ILC charter may ultimately pick up as well.

"You are going to see movement because there is pent-up demand," said Frank Pignanelli, who represents industrial banks as a partner at the Utah government relations firm Foxley & Pignanelli. "There is pent-up demand for capital to be used either through ILCs or other state-chartered institutions and I just don't think the FDIC can stop that any longer."

An advertisement for SAS Analytics. At the top left is the SAS logo (a blue 'S' followed by 'sas.') and the tagline 'THE POWER TO KNOW.' in a smaller font. Below this, the word 'Analytics' is written in a large, elegant serif font. Underneath, the text reads 'How analytics can be used for BSA/AML compliance programs.' in a clean, sans-serif font. A prominent orange button with the text 'Read the paper' is centered below the text. The background of the advertisement features a photograph of a man in a light-colored suit and blue shirt, sitting at a desk with a laptop. He has his hands clasped in front of his chin and is looking thoughtfully at the camera.

The FDIC's approval last month of Primary Bank — a traditional community bank in Bedford, N.H. — for deposit insurance was only the second de novo approval in over four years. While a dramatic surge in new-bank activity is not likely, some experts are hoping that the continued economic recovery spurs more successful applications.

Whether a thawing in the de novo freeze also loosens up the environment for ILC applicants is still a mystery. The political hurdles for ILC seekers have been higher than for more traditional applicants for quite some time, and some believe regulators may favor proposals for more typical community banks, rather than niche institutions such as ILCs.

"The de novos that have gotten approved since the crisis have been community banks with traditional business models. The regulators would see them as the polar opposite of the typical ILC," said Barak J. Sanford, a managing director at Promontory Financial Group.

Walmart's bid a decade ago sparked strong opposition from banks, labor unions and lawmakers, worried the retailer's access to FDIC-insured deposits would allow it to use its elaborate store network to stranglehold the industry. At the time, the retailer insisted it sought a charter to be able to process in-store payments, and has shown no interest in applying for an ILC since.

The application launched a broader discussion in Washington about whether banking and commerce should mix. At the time, ILCs — limited-purpose charters that lacked some of the features of more traditional banks — were seen as the only real option for nonfinancial firms, which are generally barred from operating as a bank holding company.

As lawmakers debated possible curbs on efforts by retailers to get ILCs, the FDIC delayed action with temporary freezes on deciding applications. Some financial companies were able to get FDIC approval to own ILCs, but there has been essentially no activity since the inception of a three-year moratorium on applications required in the Dodd-Frank Act. (The moratorium expired in July 2013.)

The focus on the ILC debate largely subsided after Walmart withdrew and banking industry issues were overtaken by the 2008 crisis. Efforts to impose new restrictions on the charter in Dodd-Frank largely failed. Other than the moratorium, the reform law just mandated a Government Accountability Office report to study the issue further.

Currently, three applications that predate the Dodd-Frank moratorium are still pending at the FDIC. Ford Motor Credit filed for a charter in Utah — home to a majority of the ILCs and one of seven states where they are legal. John Deere and Caterpillar applied for ILC charters in Nevada.

With hope building that de novo applications will soon start increasing, observers said there is nothing legally standing in the way of a new ILC player launching a bid.

"We are pretty close to the possibility where you could see one of these applications fairly soon," said V. Gerard Comizio, a partner at Paul Hastings LLP. "It is now legal again for a nonfinancial company to get an industrial loan bank charter and deposit insurance for it."

State regulators say that while formal applications are still rare, they are hearing from interested parties.

"We continue to see periodic interest in the [industrial bank] charter option, mostly through phone call inquires and occasionally through meeting requests with potential applicants," said Shaun Berrett, supervisor of industrial banks for the Utah Department of Financial Institutions. "While steady, that interest has not materialized into any actual submitted applications in recent years."

When the controversy broke out before the 2008 crisis, states like Utah and Nevada always remained receptive toward ILC applicants, but federal officials were reluctant to act.

"I know at the Utah level, they would be willing to accept [ILC] applications and advance them onto the FDIC," said Brad Merrill, a partner at Snell & Wilmer, which is based in Utah. "The FDIC has been the bottleneck historically over the last decade."

Some are more pessimistic about the regulators advancing bids, even though the Dodd-Frank freeze has long expired.

"The moratorium has been lifted, but I don't think there has been openness to new charters," said Michael Krimminger, a partner at Cleary Gottlieb Steen & Hamilton and former general counsel at the FDIC.

Scott Polakoff, a former official at the FDIC and then the Office of Thrift Supervision, said ILCs remain an attractive option for firms with specialty business plans, but whether policymakers have softened their stance after so many years is still a question mark.

"The ILC charter as it stands is a charter that deserves a lot of attention," said Polakoff, now an executive vice president at FinPro. "The question is going to be ... are the regulators willing to approve ILC charters with the recognition that there is not a bank holding company above such entities?"

When asked to comment on how receptive the FDIC now is to de novo applications and new ILC applications in particular, a spokesman released a statement saying, "We welcome proposals for deposit insurance and staff are available to discuss the application process and possible business plans with potential applicants."

But Sanford said new ILC players could face challenges that were not central issues before. During the crisis, regulators grew concerned that banks with fast-growth strategies based around attracting brokered deposits were hit hard in the real estate crash, many of them failing, and officials promoted core funding strategies.

"A typical ILC would depend on noncore funding and big strategic and credit concentrations, and if you apply for a regular bank charter today with that type of business plan, you probably would not be approved — this is separate and apart from the ILC charter issue," Sanford said.

He added that the crisis — and ensuing effort to pass Dodd-Frank — emphasized the need to regulate firms at the bank company level, but ILCs still enjoy an exemption from having to create a bank holding company.

"The entire policy trend represented first and foremost by Dodd-Frank is to close the loopholes that allow some companies that control banks to avoid consolidated supervision," he said. "So I think there

is a strong interest by the bank regulators to ensure that companies that control banks do not avoid that unless there is some very special reason why they should."

But Comizio said regulators could consider processing ILC applications first for companies that are strictly financial in nature and could operate bank holding companies if they chose to. Those types of bids did not elicit the same type of opposition that met the applications by retailers.

"They might start with a financial company that would be viewed as less controversial than providing one to a nonfinancial company," he said.



© 2015 SourceMedia. All rights reserved.